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IN THE

Supreme Court of the United States

OCTOBER TERM 1969.

No. 528

UNITED STATES OF AMERICA,
Petitioner,

vs.

HILTON HOTELS CORPORATION,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

RESPONDENT'S BRIEF IN OPPOSITION.

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STATEMENT.

The statement of the facts of this case by the Petitioner omits Sections 21(6) and 21(7) of the New York Stock Corporation law, which sections are the basis of the classification of the expenditures in this case. Section 21(6) provides:

> Any stockholder demanding payment for his stock shall have no right to receive any dividends or distributions payable to holders of such stock of record after the close of business on the day next preceding the

> date of the stockholders's vote in favor of the action to which such objection was made, *and upon such vote shall cease to share any other rights of a stockholder of the corporation in respect to such stock except the right to receive payment for the value thereof.* . . . (Emphasis added.)

Section 21(7) provides:

> . . . if payment for the stock of an objecting stockholder shall have been demanded in consequence of action taken on a merger or consolidation pursuant to section eighty-five, eighty-six, or ninety-one, *the shares or other securities of the resulting or surviving corporation into which the shares of the objecting stockholder would have been converted had no objection been made shall . . . be deemed to have been duly issued in accordance with the terms of such certificate and reacquired by the resulting or surviving corporation, and may be held or disposed of by it free of any preemptive rights of stockholders.* (Emphasis added.)

Under Section 21(3) of the New York Stock Corporation Act, if a stockholder who lost his proprietary rights to stock under the above provisions was not satisfied with the monetary value the corporation placed on the stock, that stockholder could institute a proceeding for an appraisal and an accounting of the stock's value. It is the treatment of the cost of that type of proceeding which was the sole issue decided by the Appellate Court under the peculiar provisions of New York law.

ARGUMENT.

I.

THE APPELLATE COURT CORRECTLY APPLIED ESTABLISHED PRINCIPLES OF FEDERAL LAW. THIS CASE WAS RIGHTFULLY DECIDED ON THE BASIS OF A SPECIFIC FACT SITUATION.

The Petitioner asserts in its first argument that the Appellate Court erroneously did not apply an allegedly clear legal principle when it held that the expenditures of Hilton in the appraisal proceeding involving the valuation of stock in which the stockholders had lost their proprietary rights were ordinary and necessary business expenses.

The first argument of Petitioner is based on the erroneous and overly simplistic statement that all expenditures incurred in connection with the acquisition of capital assets or with a corporate reorganization are capital expenditures. This argument neglects the fact that the District Court[1] found and the Appellate Court[2] concurred that the appraisal proceedings occurred after and were separate from both the merger and the acquisition of the stockholder's proprietary rights. Further, Petitioner's generalization regarding classification of expenditures neglects the necessary appreciation of particular fact situations, for as Justice Cardoza stated:

> to attempt to harmonize them (cases determining the nature of expenses) would be a futile task. They involve the appreciation of particular situations, at times with border-line considerations.[3]

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1. *Hilton Hotels* v. *United States*, 285 F. Supp. 617 (N. D. Ill. 1968)
2. *Hilton Hotels* v. *United States*, 410 F. 2d 194 (7th Cir. 1969)
3. *Welch* v. *Helvering*, 290 U. S. 111 at 116 (1933)

As is illustrated by the cases below, the fact that one can demonstrate that there is some relationship between an expense and a capital transaction does not cause that expense to be classified as a capital expense. Courts have consistently stated that while legal expenditures related primarily to question of title to property are capital expenditures, the line of demarcation between an ordinary and necessary expense and an expenditure incurred primarily regarding title to property is extremely narrow and where the issue of title is secondary the whole expense may be deductible. The mere fact that stock ownership may somehow be affected does not mean that legal expenditures primarily involve questions of title and are automatically classified as capital expenditures, for if such were the rule of law every expenditure relative to income producing property would be a capital expenditure thereby emasculating all deductions related to income producing property.[4]

In *Usry* v. *Price*[5] the state of Louisiana had twice challenged the taxpayer's right to title and income from oil wells. The Commissioner of Internal Revenue took the position that since in the second case legal fees were incurred for the protection of title they were capital expenses. The court said that in every case where income is derived from property one may find lurking somewhere in the background a question of title. The court said that it was not its province to adjudicate the issue of title but rather it was to decide whether that issue had been adjudicated and settled and if so at what time. The court said that since the issue of title had been adjudicated in the first Louisiana

4. See *Sergievsky* v. *McNamara*, 135 F. Supp. 233, (S. D. N. Y. 1955), which involved a suit to impose a constructive trust on stock as well as to obtain an accounting for the value of other stock which had already been transferred by the defendant. Similarly, *Guttmann* v. *United States*, W. D. Pa. Civil Nos. 17037 and 17318, 60-1 USTC 9310 (1960).

5. 325 F. 2d 657 (5th Cir. 1963)

case and was *res judicata,* that issue was secondary and did not cause attorney's fees in the second case to be classified as capital expense. In *Naylor* v. *Commissioner*[6] services of an attorney were necessary to collect the proceeds of the sale of a capital asset. The taxpayer's attorney was employed *after* an enforceable contract of sale existed. His fees were held to be deductible rather than a capital expenditure.

In *Rassenfoss* v. *Commissioner*[7] the taxpayer was sued for the adjudication of a third party's claim in his partnership property and for an accounting. The court held that it was perfectly plain that the main purpose of the suit was an accounting for value and that any questions of title were merely incidental and did not control the characterization of legal fees which were deemed to be noncapital expenditures.

The following situations are but a few of those wherein legal fees were incurred and were declared to be noncapital expenditures: the acquisition of stock to better control the corporate management;[8] the regaining of title to stolen property;[9] the interference by an investment company in a reorganization proceeding involving another corporation to protect its own stock investment in that corporation;[10] the acquisition of stock to prevent a stockholder from further disrupting corporate operations;[11] the working out of a purchase procedure and valuation formula for the pur-

6. 203 F. 2d 346 (5th Cir. 1953)

7. 158 F. 2d 764, (7th Cir. 1946), Note also *Marsh* v. *Squire,* U. S. D. C. W. D. Wash. No. 993, 48-1 USTC 9142 (1947)

8. *Straub* v. *Granger,* D. C. W. D. Pa. Civil Action No. 9429-9431, 56-1 USTC 9551 (1956)

9. *Vincent* v. *Commissioner,* 219 F. 2d 228 (9th Cir. 1955)

10. *Allegheny Corporation,* 28 TC 298 (1957)

11. *General Pencil Company,* TC Memo Opinion Docket No. 3616 (June 17, 1944) (3 TCM 603, CCH Dec. 14, 002 [M]

chase of a majority stockholder's holdings under a buy-sell agreement;[12] and the stock valuation proceedings held under state law due to a merger.[13]

In the above cases capital transactions such as acquisitions of capital assets or mergers were considered incidental to the purpose for which the legal expenditures were incurred, or were deemed to be separated from such expenditures, or their capital nature was overshadowed by still other considerations. These cases illustrate the fallacy of the government's position based on the generalization that connection of an expenditure with a capital transaction causes the expenditure to be a capital expenditure. This clearly is not true.[14] Particular situations not generalizations govern the classification of expenditures. The Appellate Court rightfully based its decision on particular facts.

II.

THERE IS NO CONFLICT BETWEEN THE CIRCUITS AS TO THE NATURE OF THE EXPENSES INCURRED BECAUSE THE TRANSACTIONS INVOLVED DIFFER SUBSTANTIALLY.

Petitioner claims that there is a conflict between the circuits because two circuits differently classified expenses which arose out of appraisal proceedings to determine the value of stock held by dissenting stockholders. Petitioner neglects to show that the fact situation surrounding the appraisal proceedings as well as the statutes governing each proceeding differed greatly.

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12. *Gravois Planing Mill Co.* v. *Commissioner,* 299 F. 2d 199 (8th Cir. 1962)

13. *Smith Hotel Enterprises, Inc.* v. *Nelson,* 236 F. Supp. 303, (E. D. Wisc. 1964) *Heller* v. *Commissioner,* 147 F. 2d 376 (9th Cir. 1945) ; Cert. denied 325 U. S. 868 (1945) where the Supreme Court did not grant Certiorari in a case which was extremely similar to the instant case.

14. *Welch* v. *Helvering, supra* at Footnote 3

In *Woodward*[15] the single Iowa statute[16] that governed the appraisal proceeding dealt with dissenting stockholder's rights arising solely because of the *renewal of the corporate charter*. In *Hilton* the appraisal proceeding arose and is governed by New York statutes[17] dealing with the rights of a dissenting stockholder in a corporate *merger*. In *Woodward* assenting stockholders were required by the statute to purchase the stock of the dissenting stockholders, thus *increasing* the shares they held in the corporation. In *Hilton* it was the *corporation* which was required by statute to acquire the stock of the dissenting stockholders.[18] In *Woodward* the Iowa statute did not state that dissenting stockholders lose any of their rights as stockholders prior to the *actual* sale of their stock to assenting stockholders and such sale was not required to take place until *three years after* the vote for renewal of the charter. In *Hilton* under New York law the dissenting stockholders *upon the vote affirming the merger* ceased to have any rights of stockholders and had only the right to receive value[19] which was to be determined as of the date preceding that vote.[20] The corporation was then deemed to own their stock.[21] The appraisal proceeding in *Woodward* took place under Iowa statute *just prior to the sale* of the dissenting stockholders interest whereas in *Hilton* under New York law the dissent-

15. *Woodward* v. *Commissioner*, 410 F. 2d 313 (8th Cir. 1969)

16. Iowa Code § 491.25 (1966)

17. New York Stock Corporation Act § 21, 91

18. New York Stock Corporation Act § 21(1), 21(3), 91(7)

19. New York Stock Corporation Act § 21(6)

20. New York Stock Corporation Act § 21(4)

21. Rev. Ruling 68-285 IRB 1968-23, 17 states that on the date dissenting stockholders lost all rights of stock ownership and only had the right to value for their stock from the corporation, the corporation was deemed to own their stock; also New York Stock Corporation Act § 21(6), 21(7)

ing stockholders lost their rights as stockholders long before the appraisal proceeding.[22]

A further distinction is that the taxpayers in *Woodward* deducted the appraisal expenses under Section 212 of the Internal Revenue Code of 1954, whereas the taxpayers in *Hilton* deducted their expenses under Section 162 thereof. The 8th Circuit in the *Woodward* case specifically distinguished the 7th Circuit *Hilton* decision because *Hilton* was decided under Section 162, and further distinguished the cases by stating:

> The statute involved in Hilton specifically provides that upon objection to merger by a stockholder his shares were deemed to have been required (acquired) by the corporation. As we have seen, there is no such provision in the Iowa statutes regarding corporate renewal.

Because the facts in *Woodward* differ so completely from those in *Hilton* there is no conflict between the circuits.[23]

III.

PROVISIONS OF NEW YORK LAW BY THEIR TERMS HAD VESTED OWNERSHIP OF DISSENTING STOCKHOLDER'S STOCK IN HILTON PRIOR TO THE APPRAISAL PROCEEDING THUS THE APPRAISAL PROCEEDING WAS SEPARATE FROM THE ALREADY ACCOMPLISHED ACT OF ACQUISTION.

Petitioners maintain that the appraisal proceeding for an accounting for the value of the acquired stock after Hilton and the dissenting stockholders did not agree on its value cannot be a separate act for tax purposes from the *earlier*

22. New York Stock Corporation Act § 21(1), 21(3), 21(4), 21(6), 21(7), 91(7)

23. The brokerage fee cases cited by Petitioner are not relevant because expenses incurred for the valuation of acquired stock differ substantially from brokerage fees arising as *part* of a transaction of acquiring or selling stock.

accomplished acquisition of said stock. Saying that a legal proceeding is incidental to, grows out of, or can be foreseen as a result of another transaction begs the question as to the proper classification of the expense incurred.[24] If Petitioner's assertion was correct, expenses for the printing of new stationery, or the changing of current advertising, or because of the increase in franchise tax all due to the merger having taken place would be capital expenses and it is patently clear that they are not.[25]

Petitioner cites *Spangler*[26] and *Munson*[27] to support his contention that the appraisal proceeding and the acquisition are one transaction. In these two cases, legal expenses were incurred in defending suits to rescind or modify the terms of the original sale because said sale was fraudulently induced. The fraud reopened the terms of the original sale and made the reversion of title to the seller a strong possibility. Acquisition and defense of title were the primary issues in those cases.

In *Hilton* the terms of the sale (including the method of stock valuation by court proceedings, if necessary) were established by statute and further ownership of the stock was not in question. Fees incurred in a controversy over the amount due under an enforceable sale of stock are deductible rather than capitalized because the dispute is over valuation of the stock rather than over title to stock or over the duty to deliver the stock.[28]

Petitioner also cited *Arrowsmith,*[29] but that case dealt

24. Respondent's Argument I makes it clear that particular situations govern classifications rather than the finding of some connection to a capital transaction.

25. *Hilton Hotels* v. *Commissioner,* 285 F. Supp. 617 at 618-619 (N. D. Ill. 1969)

26. *Spangler* v. *Commissioner,* 323 F. 2d 913 (9th Cir. 1963)

27. *Munson* v. *McGinnes* 283 F. 2d 333 (3rd Cir. 1960)

28. *Naylor* v. *Commissioner,* 203 F. 2d 346 (5th Cir. 1953)

29. *Arrowsmith* v. *Commissioner,* 344 U. S. 6 (1952)

with whether subsequent accounting and reporting periods affected the classification of expenses and therefore is not germane to the instant case.

It is clear that attorney fees and other appraisal expenses in *Hilton* were not for services relating to the merger or stock acquisition, both of which had already been accomplished under statute[30] but rather were incurred in an appraisal proceeding accounting for the proper amount of money due.[31]

IV.

AN OBSERVATION IN THE OPINION OF ONE CIRCUIT COURT DOES NOT CREATE A CONFLICT BETWEEN CIRCUITS FOR RESOLUTION BY THE UNITED STATES SUPREME COURT AND FURTHER THAT OBSERVATION CAUSED NO CONFLICT BETWEEN THE CIRCUITS.

Petitioner attempts to show a conflict between circuits based on the observation in the Eighth Circuit in *Woodward* that because the acquisition of property is involved it "thus had no need to apply the primary purpose test." Petitioner argues (erroneously) that the origin of the appraisal expenses in *Hilton* was a stock acquisition, and says that because there was a mention of the primary purpose test in *Hilton* by the Seventh Circuit, a conflict is

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30. New York Stock Corporation Act § 21(1), 21(3), 21(4), 21(6), 21(7), 21(9) & 91(7) Also note Rev. Ruling 68-285 IRB 1968-23, 17 stating under circumstances where dissenting stockholders only retain the right to have the corporation pay for the stock, the corporation was deemed to own their stock.

31. *Naylor* v. *Commissioner*, 203 F. 2d 346 (5th Cir. 1953); *Rassenfoss* v. *Commissioner*, 158 F. 2d 764, (7th Cir. 1946); *Marsh* v. *Squire*, USCD W. D. Wash. No. 993, 48-1 USTC 9142 (1947); *Sergievsky* v. *McNamara*, 135 F. Supp. 233, (S. D. N. Y. 1955); *Smith Hotel Enterprises, Inc.* v. *Nelson*, 236 F. Supp. 303, (E. D. Wisc. 1964)

created with the observation of the Eighth Circuit which must be resolved by the United States Supreme Court.[32]

This observation by the Eighth Circuit in *Woodward* was not the basis of its decision. Its decision was based on the fact that an appraisal proceeding was an integral part of a stock purchase. Respondent's Argument III and other prior arguments show that the appraisal in *Hilton* is separate from the earlier acquisition of the stock which was accomplished by operation of law. The Eighth Circuit's observation that the primary purpose test is not applied to the acquisition of property does not create a conflict with *Hilton* where the property was deemed by statute to be acquired prior to incurring the appraisal expenses.

Though the Seventh Circuit Court of Appeals mentions the primary purpose test in *Hilton,* it in fact rendered its decision based on the *sole purpose* of the appraisal proceeding which was to determine the fair value of those Waldorf shares which Hilton had acquired. Certainly no court can ignore the sole purpose of a transaction.

V.

THE SEVENTH CIRCUIT COURT OF APPEALS DECISION IN THE HILTON CASE WAS DECIDED UNDER PECULIAR PROVISIONS OF NEW YORK LAW AND IS NOT A DECISION FOR GENERAL APPLICATION.

Petitioner claims that the Seventh Circuit Court of Appeals erred in its conclusion that the *Hilton* decision was a narrow one applied specifically to a factual situation controlled by New York statutes. Petitioner has based this claim on the fact that forty-eight states and the District of Columbia accord dissenting shareholders an appraisal

32. Respondent does not believe that Certiorari is granted to resolve observations.

remedy. This fact relied on by the Petitioner for the wide applicability of the *Hilton* decision is again based on an erroneous and overly simplistic approach because indicating that states grant appraisal remedies is meaningless without determining what such remedies are and what effect they have on dissenting stockholder's rights.

Under New York statutes the stockholder must both object and demand payment for his stock before the date for the stockholders to vote on the merger.[33] On the date the merger is approved the objecting stockholder ceases to have any rights of a stockholder and only has the right to receive payment for the value of the stock he had held.[34] On that date the corporation is deemed to own the dissenting stockholder's stock.[35] The merger becomes effective at a time after the dissenting stockholder has lost the rights in his stock.[36] After the vote, the corporation should offer the dissenting stockholder compensation for his lost stock rights that the corporation obtained.[37] If this offer is not forthcoming, or is unsatisfactory, the dissenting stockholder may commence a valuation proceeding to determine the true value of the stock as of the day before the affirmative vote for merger when his rights were lost.[38] No other state's statutes cause a dissenting stockholder *prior* to the date the merger is effected to lose all his proprietary stock rights and be granted only the right to receive the value of the stock.[39] This is ignored by Petitioner when it is

33. New York Stock Corporation Act § 91(7)

34. New York Stock Corporation Act § 21(6)

35. *Supra* Footnote 21

36. New York Stock Corporation Act § 21(6), 21(9)

37. New York Stock Corporation Act § 21(1), 21(3)

38. New York Stock Corporation Act § 21(3)

39. With reference to the statutes cited by Petitioner on page 15 of this brief. a. Shareholder loses all proprietary rights only on receipt of agreed payment for his stock in the following states: Ala., Alaska, Ariz., Ark., Cal., Colo., D. C., Ga., Hawaii, Idaho,

one important fact upon which the Seventh Circuit Court of Appeals rendered its decision in the *Hilton* case. The loss of rights and the merger occurred long before the valuation proceeding.

Petitioner also states that the *Hilton* decision is of general applicability because "it is a general rule that a duly approved merger or consolidation becomes effective upon the filing or recordation of an appropriate certificate though some shareholders may have dissented." To say that a merger can occur despite opposition is meaningless to the instant case. It in no way aids in the classification of an expense.

A corporation is a creature of local and state law which determines its stockholder's rights, obligations, and relationships.[40] New York law cannot be ignored and the fact that suits may be pending under the laws of other states is irrelevant. Furthermore, appraisal expense considerations are not key factors in mergers as Petitioner contends because the amount of expense involved and the tax treatment thereof are not of major importance when compared to much larger expenditures for the corporation's purchase of dissenting stockholder's stock and more important tax considerations involved in the general area of tax free mergers.

This case was rightfully decided under the proper appli-

Ill., Iowa, Me., Mass., Minn., Mo., Mont., Neb., N. H., N. C., N. D., Okla., Pa., R. I., S. C., Texas, Wisc. *b.* Shareholder loses general proprietary rights in stock after merger and only after a demand is filed with the corporation in the following states: Conn., Del., Fla., Kan., La., Md., Mich., Miss., N. M., Nev., Ohio, Ore., S. D., Tenn., Utah, Va., Wash., Wyo. *c.* General proprietary rights are lost on merger date: Ind., *d.* General proprietary rights are lost on institution action for value on stock by shareholder: Ky., *e.* Hybrid (rights lost after merger): N. J., Vt.

40. *Hopkins Savings and Loan Association* v. *Cleary*, 296 U. S. 315 (1935), *Aquilino* v. *United States*, 363 U. S. 509 (1960).

cation of federal tax laws to distinctive legal and property rights resulting from the application of provisions of New York law and New York law is not of general application to corporate reorganizations in other states.

CONCLUSION.

For the reasons set forth above indicating that Petitioner has stated no valid reasons for Certiorari, the Petition for Certiorari should be denied.

Respectfully submitted,

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Joiner in petition for
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Vide No. 412 for Brief
for Commissioner + U.S.
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